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TAGS: ECON EFIN ETRD PGOV UY
SUBJECT: URUGUAY AVOIDS ECONOMIC RECESSION, GOU THRILLED

REF: Montevideo 388

SUMMARY

¶1. (SBU) SUMMARY: Uruguay's GDP grew by a mild 0.5 percent in the second quarter of 2009, thus avoiding an economic recession. Growth was widespread among sectors, with only agriculture and electrical generation declining. The rise was led by rising public expenditure and public investment, which have generated a fiscal deficit of about 2 percent of GDP. While the deficit has been criticized by the opposition, the Ministry of Economy believes it poses no threat to fiscal sustainability. Other recent positive economic news are the GOU's successful re-entry into the sovereign debt markets (with a $500 million issuance) and several improvements concerning risk-rating. Only a month away from presidential and parliamentary elections, and caught in a heated political campaign, the Frente Amplio government has capitalized on the positive economic news.
END SUMMARY.

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MILD GROWTH IN Q2: WIDESPREAD AND LED BY PUBLIC EXPENDITURE
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¶2. (U) With the resumption of GDP growth in the second quarter, Uruguay has avoided an economic recession (defined in Uruguay as elsewhere as two consecutive quarters of fall in GDP). The Central Bank announced on September 16 that seasonally-adjusted GDP rose 0.5 percent in Q2/09 over Q1/09, leaving Q1 as the only quarter with negative growth since the onset of the global economic crisis. All economic sectors grew except for agriculture and electricity, which suffered the effects of a months-long drought. The Ministry of Economy estimates that growth could have reached 1.0 percent had it not been for the drought. Revised growth Q1/09 figures also show a milder decline in GDP than preliminary figures (2.3 percent instead of 2.9 percent).

PUBLIC EXPENDITURE KEY TO GROWTH

¶3. (U) Comparing Q2/09 to Q2/08, GDP grew by a mild 0.2 percent, fueled by growing public expenditure and public investment (up 6.5 percent and 4.7 percent, respectively). Private consumption rose slightly (0.8 percent, sustained by rising wages and low rates of unemployment), but private investment was down 16 percent. Measured in volume, imports fell 20 percent while exports surprisingly rose by 0.9 percent. Responding to criticism by the opposition that positive growth came at the expense of higher public expenditure and fiscal deficit, Director of Macroeconomic Planning Mijail Borchardt stated that the GOU's fiscal health enabled it to sustain a higher-than-expected deficit (of about 2 percent of GDP) and argued that such a deficit does not pose a threat to the sustainability of fiscal accounts. Borchardt also rejected the opposition's argument that the next government would have to pass a fiscal adjustment package.

GOU CAPITALIZES ON POSITIVE NEWS

¶4. (U) During a September 18 press conference, Deputy Minister of Economy Andres Masoller stated that Uruguay is "one of few countries in the region and the world that has weathered the global crisis without entering into a recession". He largely attributed the good result to a sound set of economic policies implemented by the Frente Amplio administration in times of prosperity, which left the GOU in a better position to face adverse international conditions. Masoller stated that the preservation of macroeconomic balances and reduction of fiscal, financial, productive and social vulnerabilities were instrumental in avoiding the recession and "differentiating Uruguay's 2009 social and economic outcome from other countries'." NOTE: Despite Masoller's statements, official statistics show that both Brazil and Argentina have also avoided falling into economic recession. END NOTE. He opined that Uruguay is well positioned to profit from the resumption of global economic growth and assessed that in CY09 poverty will continue to fall while wages and pensions will increase further.

POSITIVE OUTLOOK FOR 2009 AND 2010

¶5. (U) The positive economic figures took private analysts and even GOU authorities by surprise. During the press conference, the Ministry of Economy announced an upward adjustment of its growth forecast for 2009, from 0.7 percent to 1.2 percent. Private analysts also swiftly changed their 2009 growth forecast, from a 0.5 percent decline (in August) to 0.4 percent growth (in September). For 2010, the GOU expects 3.5 percent growth and private analysts are estimating 2.3 percent growth. A leading indicator put together by a local think-tank (CERES) hints that moderate growth will continue in Q3/09 and Q4/09. Consumer and entrepreneur confidence indicators (by Catholic University and KPMG, respectively) are also on the rise.

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SUCCESSFUL DEBT ISSUANCE AND IMPROVED SOVEREIGN DEBT RATINGS
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¶6. (U) Uruguay has been the subject of other positive economic news in recent days. After being absent from international capital markets since mid-2008, on September 21 the GOU successfully issued $500 million in dollar-denominated 16-year (2025) bonds at a 6.875 percent rate. The issuance was oversubscribed by five times (there were bids for 2,700 million), and 70 percent was purchased by investment funds operating in emerging markets. Meanwhile, country risk has gradually fallen since its December 2008 peak of 690 basis points to 275 basis points, comparable to pre-September 2008 levels. In this vein, Canadian risk-rating firm DBRS raised Uruguay's trend to "positive" based on its "improved debt profile, greater resilience to external shocks and high foreign direct investment, all in the context of its stable political system and sound macroeconomic management". DBRS also viewed "clear evidence of positive structural changes" in the economy. In mid and late July, a Japanese risk-rating firm upgraded Uruguay's sovereign rating from BB- to BB and Fitch Ratings raised its outlook to positive.

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COMMENT: GOOD AMMUNITION FOR THE POLITICAL CAMPAIGN
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¶7. (SBU) COMMENT: Though the timing of data reporting is unrelated to the political timetable, positive economic news came at the perfect time for the governing Frente Amplio. Caught in a tough political campaign and only a month away from presidential and parliamentary elections, the Frente Amplio administration is clearly trying to capitalize on the good news. Its swift adjustment of GDP growth forecasts (one day) contrasts with the 42 days it took to acknowledge negative news in its Q1 forecast. While largely attributing the avoidance of the recession to the implementation of responsible economic policies in the past, the Ministry of Economy also shot back at the opposition for past criticism about poor economic performance. At the core of the discussion lies the

fundamental question of whether a new Frente Amplio government, which would be led by Jose Mujica, could continue steering the economy in the right direction. By capitalizing on recent positive news the Frente Amplio is trying to build up its good-management credentials with a view to the campaign.

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